

## Why Stocks And Social Security Don't Mix

**A**T first glance, the proposals to privatize Social Security and allow individuals to invest their retirement funds in stocks make a compelling case. For the 10 years ended in 1996, inflation reduced purchasing power by 27 percent, but the Standard & Poor's 500-stock index surged almost 200 percent, according to the American Institute of Economic Research.

Social Security funds are now invested basically in long-term Treasury securities earning about 6 percent a year. So even with our economy's low inflation rate, the current return seems miserly compared with the sky-high returns from investments in stocks.

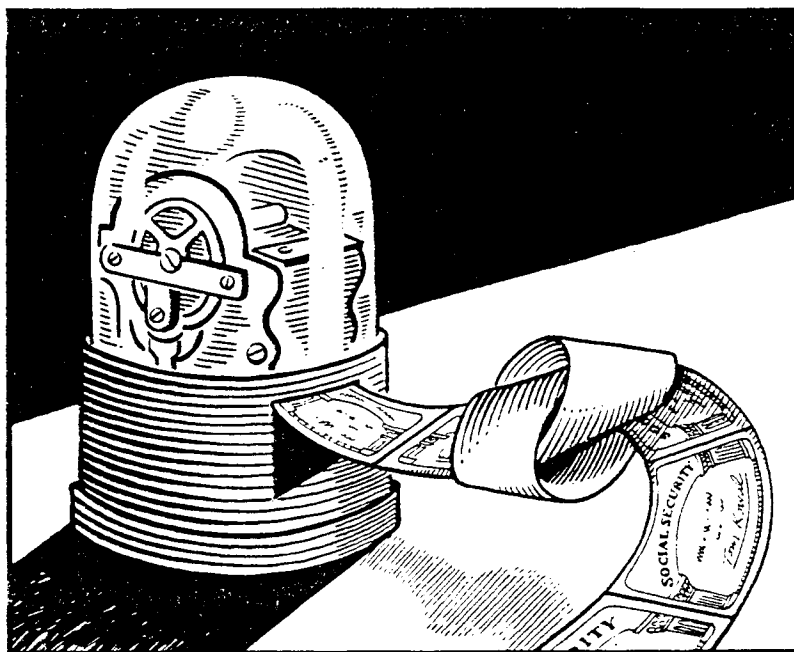
But before policy makers rush to endorse any of the investment proposals, they would be wise to consider the ripple effects. In medicine, a drug that reduces the risk of one type of cancer may increase the risk of another; we cannot accept any such trade-off when it comes to privatizing Social Security.

By any objective standard, the stock market is significantly inflated; there is simply too much money chasing too few shares, and pouring many more billions of dollars of Social Security funds into the stock market will only feed the frenzy.

The overheating of the stock market can be gauged by looking at one of the most important measures of share value — the comparison of share prices with previous-year earnings, the so-called P/E ratio.

In the 1950's, P/E ratios for the Dow industrials averaged 14. When the Dow first closed above 9,000 on March 6, the P/E at the end of that

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week was 21.78. That's high, considering that investors generally feel uncomfortable when P/E's are above a range of 15 to 18, though other factors often come into play.

**T**HERE is little question that a full privatization of Social Security would so further inflate the stock market that the bubble would soon burst, and loudly. Those of us who lived through the Great Crash, or are students of 1929, know that the ripple effect of the Roaring 20's — the Great Depression — was certainly not an acceptable trade-off.

And those of us who are seduced by the market's seemingly never-ending climb may be risking the financial security we thought stocks would insure in our retirement.

What would have happened had we invested the bulk of our retirement funds in stocks in October 1987, when the Dow began a 40 percent correction? While the compounded growth rate since then has been 16 percent annually, according to the Securities Research Corporation, the average investor unfortunately tends to sell out near the bottom.

Clearly, something must be done, and soon, to shore up Social Security, as benefits will exceed payroll taxes sometime before 2015. Rescue plans range from gradually increasing the retirement age to 67 to raising payroll taxes to reducing benefits for nonworking spouses. But it is privatization that gets the most attention.

Among the advocates of full or nearly full privatization — either im-

mediate or phased in — are Martin Feldstein, economics professor at Harvard; Representative Nick Smith, a Michigan Republican who headed a task force on Social Security, and the Cato Institute, a policy research center based in Washington. But if privatization would make the total of \$406 billion that workers and employers paid into the system last year available for individuals to invest, just imagine the effect on an already overpriced market.

A proposal advanced by Senators Daniel Patrick Moynihan of New York and Bob Kerrey of Nebraska, both Democrats, is somewhat less dangerous. They propose setting aside 2 percentage points of the total 12.4 percent Social Security tax for individuals to invest in 401(k)-type plans managed by private firms or in three plans set up by the Government. Based on data provided to Senator Moynihan's office by the Congressional Budget Office, that would amount to an average of about \$80 billion a year over the next 10 years and higher amounts later. While \$80 billion is a small fraction of the \$11.3 trillion estimated value of American stocks, such an infusion might be enough to implode the market.

The Social Security Administration says its payments are now the major source of income for 66 percent of all beneficiaries. As more and more people live well into their 80's and 90's, a sound Social Security system is more and more essential. It would be a disaster if our attempts to fix it caused its destruction. □

## THE MARKETS

## Market Place | David Barboza

State regulators announce a series of blows  
against 'boiler room' securities operations.

**S**TATE securities regulators said yesterday that they had brought enforcement actions against 75 brokerage and investment firms across the country for using high-pressure sales tactics to mislead and defraud investors.

The actions, by more than 29 state regulators, amount to one of the biggest crackdowns ever on "boiler rooms" of telephone salespeople who prey on gullible or naïve investors. The regulators netted about three times as many firms as they did in a similar sweep a year ago.

The targets are mostly small investment houses accused of using fast-talking stockbrokers to push speculative securities and investment deals, everything from worthless penny stocks to a stake in the profits of an infomercial company that hawks talking dog tags.

The regulators said they focused on boiler rooms because of their stubborn resilience in the current bull market. Boiler rooms, which have been around for decades, are crowded offices with banks of telephones staffed by brokers, often reading from detailed scripts, who call investors and pressure them to make hasty financial decisions.

"There's an overwhelming number of complaints related to boiler rooms these days," said Denise Voigt Crawford, commissioner of the state securities board in Texas, which took part in the crackdown. "Scam artists are following the headlines and pushing worthless securities."

The state regulators said that in the last few weeks they had filed more than 100 actions, from criminal indictments to small fines, against 75 firms for using abusive sales tactics and fraudulent schemes in peddling micro-cap stocks, foreign exchange investments and even investments in ostrich meat.

According to the transcript of one call, a broker tried to persuade someone — who turned out to be an enforcement agent — to invest in a

speculative initial public offering. The broker played down the speculative nature of the investment. "The risk factor is very simple, you know, you could lose your money, of course, I mean in anything that you do," he said. "But that's irrelevant because we're looking to see the stock go up, not down."

Regulators and law enforcement officials say that the length and strength of the current bull market has led many small investors to view big returns as commonplace and thereby made them vulnerable to brokers selling what they may call the next Intel or Microsoft.

"The bull market has made the work of scam artists much easier," said Ms. Crawford in Texas. "When investors are getting 30 to 40 percent returns on mutual funds, it's not hard to convince them they can make more in penny stocks."

By coordinating their enforcement actions, the regulators say they hope to put a dent in the pervasive fraud associated with boiler rooms and micro-cap stocks. Taken together, the regulatory actions cast a much wider net than a year ago, when state officials brought similar actions against individuals and 14 firms, most in the New York area. This time, the coordinated enforcement effort included states like New Hampshire and Alaska, and a large and growing concentration of boiler rooms was found in California.

In recent weeks, the regulators moved to revoke brokerage licenses, issue cease-and-desist orders, levy fines and shut down brokerage firms that engage in sales fraud.

It is not a crime for a broker to sell an investor a security that loses value, but it is illegal to guarantee investment returns or to intentionally mislead investors into buying securities that are clearly unsuitable for them, or even worthless.

"These folks aren't giving the investors the information they need to make an informed decision," said Douglas F. Wilburn, state securities

commissioner in Missouri. "In fact, they're lying to them, promising them guaranteed returns."

While the enforcement actions have curtailed some boiler room operations, regulators say that many boiler rooms continue to operate, some by moving from place to place and operating under different names. Regulators encourage investors to check a broker's background with state regulatory agencies and the National Association of Securities Dealers, each of which maintains disciplinary files on brokerage firms and individual brokers.

Mr. Wilburn in Missouri said many of the defrauded investors made little effort to find out about the brokers or the securities.

"Some of these people are so gullible, so naïve," he said. "It's very depressing to find people who believe anything they're told."

Among the companies that were accused of sales fraud were: **Biltmore Securities** in Fort Lauderdale, Fla.; **Duke & Company** and **Hillcrest Financial Group**, both of New York; **Lloyd Wade Securities** in Dallas; **Royal Palm Investments** in Boca Raton, Fla.; **Abbey-Ashford Securities** in Tampa, Fla., and the **La Jolla Capital Corporation** in San Diego.

One company accused of fraudulent sales of foreign currency investments was **Trump Financial Group**, in Aventura, Fla. Officials at these firms either offered no comment yesterday or were not available.



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## **STATE SECURITIES COPS TURN UP HEAT ON INVESTMENT BOILER ROOMS**

WASHINGTON (July 23, 1998) – State securities regulators have turned up the heat on investment boiler rooms, bringing over 100 enforcement actions.

In recent weeks, securities regulators in 29 states, from Alaska to Florida, have initiated actions, ranging from fines to criminal indictments, against boiler room operators, who are prospering in the shadows of Wall Street's bull market. They are defrauding investors with high-pressure sales of microcap stocks,<sup>1</sup> foreign exchange investments, profits from infomercials—even investments in ostrich meat.

State securities regulators brought 64 actions against 36 firms peddling microcap stocks, 27 actions against foreign currency "bucket shops" and 15 actions against other boiler room operations.

In a typical boiler room, sales people sit shoulder to shoulder at phone banks all day. They cold call potential investors using sophisticated sales scripts and high-pressure sales techniques.

"In this bull market, there's been an explosion of boiler rooms and many investors are getting burned," said Denise Voigt Crawford, Texas Securities Commissioner and president of the North American Securities Administrators Association, Inc. (NASAA), which represents state securities regulators. NASAA estimates there are hundreds of boiler rooms operating across the country, many in the New York City area, Florida and southern California. Added Crawford: "As (Securities and Exchange Commission Chairman) Arthur Levitt said, 'Boiler rooms belong in power plants, not in professional brokerage houses.'"<sup>2</sup>

<sup>1</sup> Microcap, includes penny stocks, and generally describes the low-priced securities of small companies with market capitalizations of less than \$300 million.

<sup>2</sup> Arthur Levitt, Chairman United States Securities and Exchange Commission, "The State of the Brokerage Profession" before the Securities Industry Association's Legal and Compliance Seminar, April 20, 1998.

One of the new scams is foreign exchange investments. Con artists typically follow the headlines, in this case offering investors the supposed chance to profit from Asia's currency crisis. In California, in late June, regulators brought actions against 18 firms illegally selling "forex" investments to members of southern California's Asian communities. They were solicited to invest \$5,000 to \$200,000 to buy foreign exchange instruments supposedly traded in Hong Kong and other markets.

"Microcap fraud," Crawford added, "is now on every regulator's radar screen so the con artists are moving into new products such as foreign exchange. To paraphrase Abe Lincoln, boiler room operators are fooling too many of the people too much of the time."

Investments cover the waterfront—from interests in gourmet coffee shops and internet service providers to ostrich farms. In Nevada, regulators brought criminal indictments against individuals involved with the Sterling Group, which sold supposed interests in the profits from infomercials for products such as water-filled barbells and talking dog tags.

"The original focus of this sweep was microcap stock fraud—following on the successful actions we took last year<sup>3</sup>," said Douglas F. Wilburn, Missouri's Securities Commissioner, who coordinated the multi-state action. "But as we got into it, we realized that microcap fraud, while serious, was in fact just a piece of a larger problem — boiler room sales of investments."

Indiscriminate cold-calling backfired on one boiler room operator, when cold-callers unwittingly telephoned a state securities investigator at the Texas State Securities Board. As a result, regulators in New York froze \$750,000 of the firm's assets. Often firms try to cash in on seemingly respectable names. For example, South Dakota took an action against a foreign exchange operation called Trump Financial.

In the sale of microcap stock, a big problem, according to regulators, is unauthorized trading. Regulators in Utah, for example, brought an action against J.P. Turner & Company based on a complaint by an investor, a pilot for Delta Airlines, who alleged three unauthorized trades. Regulators obtained trading and phone records from J.P. Turner. Tickets for the disputed trades were stamped at 2:54 p.m. and 2:55 p.m. Eastern time. The pilot's log showed that he landed at 3:19 p.m. at Atlanta after a trans-Atlantic flight from Germany. "Pilots usually don't talk to their brokers when they're on final approach," said Tony Taggart, Acting Director, Utah Division of Securities. For this and other securities violations, Utah is seeking to revoke J.P. Turner's license and fine the firm \$250,000.

Losses to individual investors can be crushing. A 78-year old investor in Arkansas was persuaded by a cold caller from Atlanta-based Argent Securities to sell his blue-chip portfolio and invest in microcap stocks. His eventual losses came to more than \$440,000.

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<sup>3</sup> NASAA Press Release, 5/29/1997: 20 states filed 36 actions and by year-end 33 states took over 100 actions. ([www.nasaa.org](http://www.nasaa.org))

The bull market on Wall Street has made it easier for boiler room crooks to operate, said Crawford. "When the big mutual funds are showing annual returns of 30-40 percent or more, the idea that you can double your money in a short time, as these con artists promise, doesn't sound so ridiculous."

Investors should be on guard against boiler room sales people, who prey on business people and professionals like doctors and lawyers as well as retirees, using telephone lists of potential "hot prospects."

Regulators warn investors never to buy anything over the telephone from a stranger without thoroughly checking out the investment and the person and firm selling it. Don't succumb to pressure to "buy now." "If it's a really good investment, it will be a good investment next week or next month—after you've done your home work," said Missouri's Wilburn.

Investors can check out the investment, the sales person and their firm by contacting their state securities regulator. Addresses and phone numbers are available at the NASAA web site ([www.nasaa.org](http://www.nasaa.org)) or by calling 202/737-0900.

Investors have rights when it comes to dealing with cold callers selling stocks. Under industry rules, investors can't be called before 8 a.m. or after 9 p.m. and they can demand that their name be put on a brokerage firm's "do not call" list.

If investors suspect they have been defrauded by a boiler room operator, they should contact their state securities regulator. "Individuals should not be embarrassed about being ripped off," said Crawford, "we need people to come forward so we can use their experiences to prevent other people from being victimized."

## BOILER ROOM/MICROCAP ACTIONS

### Microcap Statistics

State	Firm	Action
Alabama	The Minneapolis Company	Denial of Registration
Alabama	AIBC Investment Services Corporation	Order to Show Cause to Revoke License
Alabama	Morgan Grant Capital Corp.	Summary Suspension
Alabama	LCP Capital Corp. (formerly Lexington Capital Partners & Co.)	Order of Suspension
Alabama	GKN Securities	Order to Show Cause to Revoke License
Alabama	Meridian Equities Co.	Denial of Registration
Alabama	Duke & Co., Inc.	Cease & Desist Order
Alabama	Bennett, Mullaney & Company, Inc.	Order to Show Cause to Bar Firm from Registration
Alabama	Briarwood Investment Counsel	Denial of Registration
Arkansas	Argent Securities, Inc.	Complaint Seeking Revocation of License
California	Biltmore Securities	Surrendered Broker/Dealer License
Delaware	Lexington Capital Corp.	Summary Order to Postpone Registration, Complaint Seeking Denial filed
Delaware	Duke & Co., Inc.	Complaint filed seeking revocation
Delaware	Americorp Securities, Inc.	Complaint Filed to Revoke License
Delaware	La Jolla Capital Corp.	Complaint Filed to Revoke License, Summary Suspension
Delaware	Royal Palm Investments, Inc. f/k/a PCM Securities Ltd., L.P.	Complaint Filed to Revoke License, Summary Suspension Pending
Florida	Royal Palm Investments, Inc. f/k/a PCM Securities Ltd., L.P.	Administrative Complaint Seeking Revocation
Georgia	Argent Securities, Inc.	Notice of Proposed Administrative Revocation of License
Georgia	J.P. Turner & Company, L.L.C.	Notice of Proposed Administrative Revocation of License
Illinois	Hillcrest Financial Group	Revocation of License
Indiana	Merit Capital Association	Consent Agreement & Censure
Indiana	Wise Choice Discount Brokerage, Inc.	Summary Suspension of License
Indiana	Sauceda & Granville Securities, Inc.	Complaint Filed to Revoke License
Indiana	La Jolla Capital Corp.	Administrative Complaint Seeking Revocation
Indiana	San Clemente Securities, Inc.	Summary Suspension of License
Kansas	Meyers Pollock Robbins, Inc.	Revocation of Broker/Dealer License
Kansas	Duke & Co., Inc.	Notice of Intent to Revoke License
Maryland	Wise Choice Discount Brokerage, Inc.	Revocation of License
Maryland	Duke & Co., Inc.	Revocation of License
Maryland	Meyers Pollock Robbins, Inc.	Revocation of License
Massachusetts	Duke & Co., Inc.	Revocation of License
Massachusetts	Royal Palm Investments, Inc. f/k/a PCM Securities Ltd., L.P.	Complaint Filed to Revoke License
Massachusetts	Brauer & Associates, Inc.	Complaint Filed to Revoke License
Massachusetts	The Heritage Group, Inc.	Complaint Filed to Revoke License & Fine & Rescission
Missouri	Continental Broker-Dealer	Cease & Desist Order
Missouri	M.A. Gillespie Investment Corp.	Cease & Desist Order
Missouri	Millenium Securities Corp.	Cease & Desist Order
Missouri	J.P. Turner & Company L.L.C.	Cease & Desist Order
Missouri	La Jolla Capital Corp.	Cease & Desist Order
Missouri	LCP Capital Corp. (formerly Lexington Capital Partners & Co.)	Cease & Desist Order

Missouri	Boston Group, L.P.	Cease & Desist Order
Missouri	Royal Palm Investments, Inc. f/k/a PCM Securities Ltd., L.P.	Cease & Desist Order
Missouri	Toluca Pacific Securities Corp.	Cease & Desist Order
Missouri	SFI Investments, Inc.	Cease & Desist Order
Nevada	Duke & Co., Inc.	Revocation of License
New Hampshire	First American Equities, Inc.	Complaint Filed to Revoke License
New Hampshire	LCP Capital Corp. (formerly Lexington Capital Partners & Co.)	Consent Order-withdrawal from state, \$30,000 Fine & \$10,000 restitution
New Jersey	Meyers Pollock Robbins, Inc.	Consent Order Revoking License
New York	Stone Asset, Inc.	Civil Complaint Seeking Restitution
New York	J.P. Michaels Associates	Civil Complaint Seeking Restitution
New York	Abbey-Ashford Securities	Civil Complaint Seeking Restitution
Ohio	Duke & Co., Inc.	Summary Suspension of License
Ohio	La Jolla Capital Corp.	License Renewal Refused
Ohio	Royal Palm Investments, Inc. f/k/a PCM Securities Ltd., L.P.	Summary Suspension & Intent to Revoke License
Ohio	Wise Choice Discount Brokerage, Inc.	Summary Suspension & Intent to Revoke License
Ohio	Meyers Pollock Robbins, Inc.	Summary Suspension & Intent to Revoke License
Oklahoma	La Jolla Capital Corp.	Filed for Cease & Desist Order & Civil Penalties
Oklahoma	Lloyd Wade Securities, Inc.	Filed for Cease & Desist Order & Civil Penalties
Texas	Duke & Co., Inc.	Notice of Hearing to Revoke Registration
Texas	La Jolla Capital Corp.	Notice of Hearing to Revoke Registration
Utah	Argent Securities, Inc.	Complaint Filed to Revoke License
Utah	J.P. Turner & Company L.L.C.	Complaint Filed to Revoke License
Utah	Joseph Stevens & Company	Complaint Filed to Revoke License
Washington	Duke & Co., Inc.	Summary Suspension & Seeking Revocation of License
21 States-AL, AR, CA, DE, FL, GA, IL, IN, KS, MD, MA, MO, NV, NH, NJ, NY, OH, OK, TX, UT, WA	36 Firms	64 Actions

### Boiler Room Statistics

State	Firms	Actions
Alaska	ACC Communications	Cease & Desist Order
Colorado	Affordable Media, LLC dba Sterling Group	Temporary Restraining Order
Colorado	Venture Capitalization Company	Temporary Restraining Order
Illinois	International Brands, Inc.	Temporary Order of Prohibition
Michigan	R & R Insurance Services Investment Management, Inc.	Cease & Desist Order
Nevada	Affordable Media, LLC dba Sterling Group	Criminal Complaint
New York	World Interactive Gaming Corporation	Froze Assets of \$750,000
North Carolina	Affordable Media, LLC dba Sterling Group	Summary Order to Cease & Desist
South Dakota	Capital Enhancement Association of America	Cease & Desist Order
South Dakota	Agkoda Holdings, Inc.	Cease & Desist Order
Wisconsin	Robo Enterprise Inc.	Consent Order of Prohibition &

		Revocation
Wisconsin	Financial Growth Consultants, LLC dba Sterling Marketing Group	Summary Order of Prohibition & Revocation
Wisconsin	Global Financial Instruments	Summary Order of Prohibition & Revocation
Wisconsin	North American Medical Products Inc.	Summary Order of Prohibition
Wisconsin	Lean-Farm Meats, Inc.	Summary Order of Prohibition
9 States-AK, CO, IL, MI, NV, NY, NC, SD, WI	12 Firms	15 Actions

### Foreign Exchange Statistics

Arizona	Eastern Vanguard Forex Ltd.	Complaint Alleging a Fraud, Seeking Relief & a Fine
Arizona	Forex Investment Services Corporation	Complaint Alleging a Fraud, Seeking Relief & a Fine
Arizona	Y & T, Inc. dba Tokyo International Investment Ltd.	Complaint Alleging a Fraud, Seeking Relief & a Fine
Arizona	Eastern Vanguard Group Ltd.	Complaint Alleging a Fraud, Seeking Relief & a Fine
California	Currex International Corporation	Cease & Desist Order
California	Golden Capital International Financial, Inc.	Cease & Desist Order
California	Noble Wealth, Inc.	Cease & Desist Order
California	Newport Chase Trust Capital Growth of Newport Beach	Cease & Desist Order
California	Newportchase International, Inc.	Cease & Desist Order
California	General Financial	Cease & Desist Order
California	Cash Investment Group	Cease & Desist Order
California	Delong Foreign Exchange, Inc. aka DVX, Inc.	Cease & Desist Order
California	China Development Group Corp.	Cease & Desist Order
California	Morex Financial, Inc.	Cease & Desist Order
California	Centrex Management, Inc.	Cease & Desist Order
California	CMI, Inc.	Cease & Desist Order
California	Fortrex Management Corporation	Cease & Desist Order
California	Global Risk Management	Cease & Desist Order
California	Optima Financial Services	Cease & Desist Order
California	Draco Trading, Inc.	Cease & Desist Order
California	TDM Global Exchange	Cease & Desist Order
Idaho	Options Trading Group	Cease & Desist Order, \$100,000 civil penalty
Indiana	Risk Capital Management	\$15,000 Civil Fine
Indiana	AFX Foreign Exchange, Inc.	Cease & Desist Order
South Dakota	Trump Financial Group, Corp.	Cease & Desist Order
South Dakota	International Capital Management, Inc.	Cease & Desist Order
South Dakota	Cen-Tex Alchemy Guild	Cease & Desist Order
5 States-AZ, CA, ID, IN, SD	27 Firms	27 Actions

### TOTALS

29 States	75 Firms	106 Actions
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